

General Information Letter: Nexus determinations generally cannot be made in the ruling process.

September 11, 2006

Dear:

Your letter dated August 24, 2006 has been referred to the undersigned for a reply. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("**PLRs**") and General Information Letters ("**GILs**"). **PLRs** are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A **PLR** is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the **PLR** are correct and complete. **GILs** do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information, the regulation governing the issuance of letter rulings, *2 Ill. Adm. Code Part 1200* regarding rulings and other information issued by the Department, can be accessed at the Department's website. That address is www.revenue.state.il.us/legalinformation/regs/part1200.

The nature of your question and the information provided require that we respond only with a **GIL**.

In your letter you state in part as follows:

One of our clients is a California-based LLC, and we are trying to determine if it is doing business in Illinois and if it has nexus there.

This client provides a medical coding service to hospitals, in which its employees convert doctor's reports into medical codes for insurance and Medicare reimbursement purposes.

Our client will have a W-2 employee residing in Illinois, but no revenue from Illinois sources and no assets in Illinois.

A. Does the fact that the company has a W-2 employee living in the state automatically create nexus for the company in Illinois?

B. If not, in which of the following three scenarios is nexus created?

1. If all of the Illinois employee's work is performed outside of Illinois at clients' offices?
2. If all of the Illinois employee's work is performed as his/her home, but the work is for clients outside of Illinois?
3. If the Illinois employee's work is performed at his/her home, and the work is for Illinois clients?

RULING:

The determination whether a taxpayer has nexus with Illinois is extremely fact-specific. Therefore, the Department does not issue rulings regarding whether a particular taxpayer has nexus with the State.

However, general information regarding nexus with Illinois for income tax purposes may be provided.

Constitutional Jurisdiction

The United States Constitution restricts a state's power to subject to income tax foreign corporations. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction the state seeks to tax (*Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904 (1992)). Similarly, the Commerce Clause requires that a state's tax be applied only to activities with a substantial nexus to the taxing state (*Id.*). Where any part of a foreign corporation's income is allocable to Illinois in accordance with the provisions of Article 3 of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/301 – 304), Illinois can demonstrate the connection or nexus necessary to subject a foreign corporation to tax. Therefore, unless protected by the United States Constitution or federal statute (e.g., *Public Law 86-272*, see below), a foreign corporation is liable for Illinois income tax where any portion of its income is allocated to Illinois.

IITA section 304 provides for taxable years ending on or after December 31, 2000 that the apportionment factor for a foreign corporation deriving business income from Illinois and one or more other states shall be equal to its sales factor. Section 304(a)(3)(A) defines the sales factor as a fraction, the numerator of which is the total sales of the person in Illinois during the taxable year, and the denominator of which is the total sales of the person everywhere. Department of Revenue Regulations ("regulations") section 100.3700(c)(1) states that gross receipts from sales of tangible personal property are allocable to Illinois for sales factor purposes if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of sale. Regulations section 100.3370(c)(3) provides that gross receipts from sales other than of tangible personal property are allocable to Illinois if the income producing activity that gave rise to the receipts is performed wholly in Illinois, or the income producing activity is performed in Illinois based on costs of performance.

The Illinois Income Tax Act (hereinafter "IITA," 35 ILCS 5/101 et seq.) Section 304(a)(3)(C) states as follows:

(C) Sales, other than sales governed by paragraphs (B) and (B-1), are in this State if:

(i) The income-producing activity is performed in this State; or

(ii) The income-producing activity is performed both within and without this State and a greater proportion of the income-producing activity is performed within this State than without this State based on performance costs.

Income producing activity is further discussed in 86 Ill. Adm. Code Section 100.3370(c)(3):

3) Sales other than sales of tangible personal property in this State. The sales factor includes gross receipts from transactions other than sales of tangible personal property (including transactions with the United States Government); gross receipts are attributed to this State if the income producing activity which gave rise to the receipts is performed wholly within this State. Also, gross receipts are attributed to this State if, with respect to a particular item of income, the income producing activity is performed in

this State, based on costs of performance.

A) Income producing activity defined. The term "income producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the person in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a person, such as those conducted on its behalf by an independent contractor. The mere holding of intangible personal property is not, of itself, an income producing activity. Accordingly, the income producing activity includes but is not limited to the following:

- i) The rendering of personal services by employees or the utilization of tangible and intangible property by the person in performing a service.
- ii) The sale, rental, leasing, licensing or other use of real property.
- iii) The rental, leasing, licensing or other use of tangible personal property.
- iv) The sale, licensing or other use of intangible personal property.

B) Costs of performance defined. The term "costs of performance" means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the person.

C) Application. Receipts (other than from sales of tangible personal property) in respect to a particular income producing activity are in this State if:

- i) the income producing activity is performed wholly within this State; or
- ii) the income producing activity is performed both in and outside this State and a greater proportion of the income producing activity is performed in this State than without this State, based on costs of performance.

D) Special Rules. The following are special rules for determining when receipts from the income producing activities described below are in this State.

...

iii) Gross receipts for the performance of personal services are attributable to this State to the extent such services are performed partly within and partly without this State, the gross receipts for the performance of such services shall be attributable to this State only if a greater portion of the services were performed in this State, based on costs of performance. Where services are performed partly within and partly without this State and the services performed in each state constitute a separate income producing activity, the gross receipts for the performance of services attributable to this State shall be measured by the ratio which the time spent in performing such services in this State bears to the total time spent in performing such services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligation which gives rise to such gross receipts. Personal service not

directly connected with the performance of the contract or other obligation, as for example, time expended in negotiating the contract, is excluded from the computations.

Example: Corporation X, a road show, gave theatrical performances at various locations in State X and in this State during the tax period. All gross receipts from performances given in this State are attributed to this State.

Example: A public opinion survey corporation conducted a poll by its employees in State X and in this State for the sum of \$9,000. The project required 600 man hours to obtain the basic data and prepare the survey report. Two hundred of the 600 man hours were expended in this State. The receipts attributable to this State are \$3,000, calculated as follows: $200/600 \times \$9,000$.

Your letter indicates that the client sells the service of medical coding, with no revenues being derived from Illinois. As a result, even though the presence of an employee within Illinois might create nexus with this State, the client would have no Illinois apportionable income. Conversely, under the facts presented in your question B. 3., if the work performed by your Illinois employee in Illinois for an Illinois customer produces income for Client, that will likely constitute "income producing activity in Illinois" under 86 Ill. Adm. Code 100.3370(c)(3)(A)(i) mentioned above, which in turn will result in Illinois apportioned sales for Client.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and wish to obtain a binding private letter ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of 86 Ill. Adm. Code 1200.110(b). If you have questions regarding this GIL you may contact the Legal Services Office at (217) 782-7055. If you have further questions related to Illinois income tax laws, visit our web site at <http://tax.illinois.gov/> or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely yours,

Jackson E. Donley,
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